January 28, 2004

Mr. Jim Sylph  
Technical Director  
International Auditing and Assurance Standards Board  
545 Fifth Avenue, 14th Floor  
New York, New York 10017 USA  
(Email: Edcomments@ifac.org)

Dear Mr. Sylph,

Re: IAA Comments regarding Proposed Revised International Standard on Auditing 240

Further to my predecessor’s letter to you of November 14, 2003 forwarding the International Actuarial Association’s (IAA) draft comments on the IAASB’s Proposed Revised International Standard on Auditing 240, The Auditor’s Responsibility to Consider Fraud in an Audit of Financial Statements, I am pleased to confirm that the IAA’s due process is now complete. The draft comments, as submitted, have been approved by the Full Member associations for release as an IAA public statement.

A copy of the final document is enclosed for your files.

Yours sincerely,

Luis Huerta  
President

Attachment: Final comments
A Commentary on the
PROPOSED REVISED INTERNATIONAL STANDARD ON AUDITING 240
The Auditor’s Responsibility to Consider Fraud
in an Audit of Financial Statements

Released by the International Auditing and Assurance Standards Board: August 2003

International Actuarial Association
The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our fifty Full Member actuarial associations represent more than 95% of all actuaries practicing around the world. The Full Member associations of the IAA are listed in an Appendix to this statement. The IAA promotes high standards of actuarial professionalism around the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within, or likely to have an impact upon, the areas of expertise of actuaries.

We are not a trade association and do not represent the interests of either clients or employers. As actuaries, we have developed significant experience and expertise in the assessment of the value of contingent cash flows. Using this experience, actuaries will as a profession continue to provide assistance to those involved in the enhancement of financial reporting standards that will command respect from users of financial statements.

The IAA appreciates this and other opportunities to provide input to and assistance in the development of the IAASB’s auditing standards. The IAA would be pleased to provide any assistance you deem appropriate based on our expertise in the furtherance of this objective. We commend the continuing efforts of the IAASB in its very worthwhile effort to develop globally accepted international auditing and assurance standards.

Due Process
These comments have been prepared by the Insurance Accounting Committee of the IAA, the members of which are listed by name and association in the Appendix to this statement. These comments which were circulated for approval to the Full Member associations of the IAA as part of our due process procedures have been approved as a public statement of the IAA.

IAA Comments
Overall, the IAA believes that the Proposed Revised ISA represents an advance in the development of international auditing standards. In addition, we are pleased that every effort was made to incorporate the basic principles and essential procedures contained in SAS 99 and that continued efforts at convergence of this and related matters with other auditing standard setters around the world will continue.

1. Paragraph 4 through 6. In paragraph 4, fraud is identified as an intentional action resulting in a misstatement. This may inadvertently cover intentional actions taken to simplify approaches used in the calculations not with the intention to misstate results. Paragraph 5
identifies an error as being an unintentional misstatement…. i.e., not an action that may result in a misstatement. To avoid misunderstandings regarding these definitions, we suggest that paragraph 4 clearly define fraud as in paragraph 6, i.e., an intentional act …. involving the use of deception to obtain an unjust or illegal advantage.

2. Paragraph 6 through 10. These paragraphs identify the two sources of fraud as i) fraudulent financial reporting and ii) misstatements resulting from misappropriation of assets. Although included in the first is “intentional biasing assumptions and judgments used to estimate account balances,” the examples included in the body of the proposed standard seem to focus more on asset balances rather than on both asset and liability balances. In our experience and as indicated in the Appendix, such fraud could incorporate both. Even though paragraph 75 does refer to provisions and reserves, it would be somewhat clearer to expand the second bullet of paragraph 9 as “Intentionally biasing assumptions and judgments used to estimate account balances, including assets and liabilities.” In addition, we note that the second source of fraud can encompass acts that, rather than being a misappropriation of past or current assets, can constitute a reduction in potential future assets or can result in an increase in liabilities, such as a reduced amount of funds receivable from a reinsurer and the intentional overstatement or misrouting of current and future claims payments.

3. Paragraph 10. Reference is made to “efforts of management to manage earnings.” We believe that a more rigorous definition of management of earnings or additional examples might add to the usefulness of ISA 240. We believe that this is an important concept not only in this ISA, but in the revised ISA 540, Auditing of Accounting Estimates, currently under development.

4. Paragraph 74. In many instances management employs or utilizes experts in the development of accounting estimates. An assessment of the incentives provided to such experts or the extent of review of the estimates and the control over the process of developing these estimates would be appropriate, which although not definitive, could lead to further investigation, e.g., if the expert’s compensation is based in part on the result of the estimates made.

5. Paragraphs 74 and 75. Fraud in connection with the preparation of estimates is a significant issue and can be difficult to detect. We encourage the IAASB to address this issue rigorously in conjunction with its project on ISA 540, Audit of Accounting Estimates, (during which ISA 545, Auditing Fair Values, should also be reviewed). Enhancement to that ISA should also consider how these paragraphs should be correspondingly modified. For example, in reference to “bias” in both of these paragraphs, because of the uncertainties associated with insurance contingencies, an insurance company could prepare its estimates of liabilities using a degree of prudence in a manner consistent with the IASB Framework. This prudence could be viewed as being a possible intentional bias in the calculation of estimates, which subsequent experience would prove sufficient or deficient. Due to the uncertain nature of such liabilities, it may be difficult to judge, even after a period of time has elapsed, whether such a bias was intended to deceive or to achieve a designated earnings level, or was based on sound actuarial practices. This may turn out to be an important distinction, especially
when insurance practitioners change to a new method of measuring liabilities, such as might arise in conjunction with the IASB’s change in the financial reporting of insurance contracts. We note that in paragraph 75 the reference to provisions or reserves is particularly problematic, since it might be quite difficult to differentiate between fraudulent and non-fraudulent estimates of actuarially determined liabilities.

6. Paragraph 37 and 38. Although there is reference to “management’s processes for identifying and responding to the risks of fraud,” no reference is made to the need for analysis of the adequacy of management’s general risk management personnel and processes. Although these internal processes may provide lip service to the detection of fraud, it is common that such efforts provide limited focus on fraud identification and prevention. The work of the auditor should include an assessment of whether adequate general risk management procedures are practiced and whether relevant information is available to risk managers that could be used to assess the possibility of fraud.

7. Appendix I. We note that the risk factors described in this appendix will certainly exist in almost all cases, e.g., “high degree of competition” and “new accounting, statutory or regulatory requirements.” Although we do not offer specific suggestions, we encourage the IAASB to review the list of factors included to provide more focused guidance and assistance for the auditor’s use. In addition, we note that in certain cases, at least in financial institutions, it is not the existence of these risk factors, but rather how the extent that these risks are managed that would provide evidence of circumstances that can lead to fraudulent financial reporting.

8. Use of an expert. Although the use of an expert is referred to in Appendix 2, page 37, this reference appears to be restricted to the development of independent estimates for comparison with those of management. Although we certainly encourage this use when appropriate (and also agree that ISA 620, Using the Work of an Expert should be enhanced), it would add value to the proposed ISA 240 to refer in a more general way to the use of an expert, e.g., in circumstances in which fraud could exist, the use of an expert could include assistance in the identification of areas of risk. In addition, particularly in the insurance industry, experts are involved in the preparer’s measurement of the liabilities arising from insurance contracts. We suggest that the standard refer to the assessment by the auditor of the relevant qualification and independence of these experts and whether or not management has used the measurements by the expert in the preparation of its accounts.

Along with other responders to the Proposed Revised ISA 240, the IAA appreciates the opportunity to express our views in the IAASB’s due process procedures and hope our comments add value to the IAASB’s deliberations.
Members of the IAA’s Insurance Accounting Committee

Sam Gutterman (Chair)
W. Paul McCrossan (Vice-chair)
Francis Ruygt (Vice-chair)
Clive Aaron Institute of Actuaries of Australia
William Abbott Institute of Actuaries
Yutaka Amino Institute of Actuaries of Japan
Félix Arias Bergadà Col.legi d’Actuaris de Catalunya
Daniel Barron Israel Association of Actuaries
Ralph Blanchard Casualty Actuarial Society
Guy Castagnoli Association Suisse des Actuaires
Paolo De Angelis Istituto Italiano degli Attuari
Mark J. Freedman Society of Actuaries
Mariano Gongora Roman Instituto de Actuarios Españoles
Stephen Handler Actuarial Society of South Africa
William C. Hines American Academy of Actuaries
Antony John Jeffery Society of Actuaries in Ireland
Ad A.M. Kok Het Actuarieel Genootschap
Kurt Lambrechts Association Royale des Actuaires Belges
Jean-Pierre Lassus Institut des Actuaires
Kristine Lomanosvka Latvijas Aktuaru Asociacija
W. Paul McCrossan Canadian Institute of Actuaries/Institut Canadien des Actuaires
Markku Paakkanen Suomen Aktuaariyhdistys
Venkatarama Rajagopalan Actuarial Society of India
Nithiarani Rajasingham Singapore Actuarial Society
Dieter Silbernagel Deutsche Aktuarvereinigung e. V. (DAV)
David Stevenson Faculty of Actuaries
Bjarni Thordarson Félag Islenskra Tryggingastærðfræðinga
Wilma Torres Instituto Brasileiro de Atuária (IBA)
Robert E. Wilcox Conference of Consulting Actuaries
Kevin Yah Actuarial Society of the Republic of China
Jesús Zúñiga Colegio Nacional de Actuarios A. C.
Appendix

Full Member Associations of the IAA
Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires
(Argentina)
Institute of Actuaries of Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Association Royale des Actuaires Belges (Belgique)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Canadian Institute of Actuaries/Institut Canadien des Actuaires (Canada)
Cyprus Association of Actuaries (Cyprus)
Ceská Společnost Aktuárů (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Eesti Aktuaaride Liit (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuaires (France)
Deutsche Aktuarvereinigung e. V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Magyar Aktuárius Társaság (Hungary)
Félág Íslenskra Tryggingastærðfræðinga (Iceland)
Actuarial Society of India (India)
Society of Actuaries in Ireland (Ireland)
Israel Association of Actuaries (Israel)
Istituto Italiano degli Attuari (Italy)
Institute of Actuaries of Japan (Japan)
Japanese Society of Certified Pension Actuaries (Japan)
Latvijas Aktuāru Asociācija (Latvia)
Lebanese Association of Actuaries (Lebanon)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A. C. (Mexico)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Actuarial Society of the Philippines (Philippines)
Polskie Stowarzyszenie Aktuariuszy (Poland)
Instituto dos Actuários Portugueses (Portugal)
Academia de Actuarios de Puerto Rico (Puerto Rico)
Singapore Actuarial Society (Singapore)
Slovensko Aktuarsko Drustvo (Slovenia)
Actuarial Society of South Africa (South Africa)
Col.legi d'Actuaris de Catalunya (Spain)
Instituto de Actuarios Españoles (Spain)
Svenska Aktuarieföreningen (Sweden)
Association Suisse des Actuaires (Switzerland)
Actuarial Institute of the Republic of China (Taiwan R.O.C.)
Faculty of Actuaries (United Kingdom)
Institute of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
Society of Actuaries (United States)